

Audit

Report



OUTSOURCING OF DEFENSE COMMISSARY AGENCY OPERATIONS

Report No. 99-078

February 5, 1999

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Department of Defense

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Acronyms

DeCA	Defense Commissary Agency
DFAS	Defense Finance and Accounting Service
FTE	Full-Time Equivalent
MEO	Most Efficient Organization
OMB	Office of Management and Budget
U.S.C.	United States Code



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

February 5, 1999

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
AND TECHNOLOGY
DIRECTOR, DEFENSE COMMISSARY AGENCY**

**SUBJECT: Audit Report on Outsourcing of Defense Commissary Agency Operations
(Report No. 99-078)**

We are providing this report for review and comment. This report is the first in a series on Defense agencies' performance of commercial activities. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Defense Commissary Agency provide additional comments on Recommendation 2., in response to the final report, by April 6, 1999.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Garold E. Stephenson at (703) 604-9332 (DSN 664-9332) (gstephenson@dodig.osd.mil) or Mr. Benjamin A. Mehlman at (703) 604-9252 (DSN 664-9252) (bmehlman@dodig.osd.mil). See Appendix C for the report distribution. Audit team members are listed inside the back cover.

A handwritten signature in black ink, reading "Robert J. Lieberman", is positioned above the typed name.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-078
(Project No. 8CH-0008.00)

February 5, 1999

Outsourcing of Defense Commissary Agency Operations

Executive Summary

Introduction. The Defense Commissary Agency (DeCA) operates 298 stores in the continental United States and overseas that sell groceries, health and beauty products, and household supplies to members and retirees of the U.S. Armed Forces, their families, and other authorized patrons. During FY 1997, DeCA had sales totaling about \$5 billion and an operating budget, which is funded by Congressional appropriations, of about \$971 million. It employs 17,646 full-time equivalent personnel, including 15,335 at commissary stores. Section 10 United States Code 2482(a) prohibits the contracting out of whole commissary stores. During FY 1997, DeCA performed seven outsourcing studies of functions performed at store level by 219 personnel. During FYs 1998 through 2003, DeCA plans to subject functions performed by 700 personnel to outsourcing studies or direct conversion to contract.

This report is the first in a series on Defense agencies' performance of commercial activities.

Objectives. The overall objectives were to determine the accuracy of inventories of commercial activities subject to study for outsourcing and privatization, evaluate the reasonableness of in-house cost estimates, and identify inherently governmental functions for outsourcing studies reported and initiated by the Defense agencies. We also reviewed the DeCA management control program as it related to the other objectives.

Results. Although the DeCA commercial activities inventory reports for FYs 1996 and 1997 fairly presented the total in-house personnel for operating locations, the coding of 2,431 in-house employees in FY 1996 and 788 employees in FY 1997 was faulty. The faulty coding was caused by DeCA interpretation of legislation and guidance. Additionally, cost reductions that DoD expected to achieve from the DeCA commercial activities program may not be realized because DeCA considers large cost comparison studies to be incompatible with its core function of delivery of a commissary benefit. Also, DeCA withdrew from a study involving 493 full-time equivalent accounting employees and has not rescheduled the study. As a result, future reporting of a significant number of employees as exempt from cost comparison study and the small-scale functions that DeCA plans to study and convert directly to contract during FYs 1999 through 2003 will limit the cost avoidance that DoD can expect from the DeCA commercial activities program. See Appendix A for a discussion of the management control program.

Summary of Recommendations. We recommend that the Director, Defense Commissary Agency, develop guidance for the positions in the 1998 commercial activities inventory that are identified as "Exempt by Legislation." We also recommend initiation of an outsourcing cost comparison study of above-store level accounting operations during FY 1999 or 2000.

Management Comments. DeCA and the Deputy Under Secretary of Defense (Industrial Affairs and Installations) provided comments on the draft report. DeCA concurred with the recommendation to develop guidance for commercial activities inventory positions identified as "Exempt by Legislation," and stated it would complete the guidance by June 15, 1999. DeCA nonconcurred with the recommendation to initiate an outsourcing cost comparison study of above-store level accounting operations. DeCA stated that the accounting personnel at its regional offices should be exempt from study because the personnel either provide an essential core civilian manpower function or a critical Government presence. DeCA stated that its determination was based on the provisions of an April 20, 1998, Under Secretary of Defense (Personnel and Readiness) and the Under Secretary of Defense (Acquisition and Technology) memorandum on inherently governmental and commercial activities inventory procedures. The Deputy Under Secretary of Defense (Industrial Affairs and Installations) concurred with both recommendations. He agreed with the conclusion that a cost comparison study of DeCA accounting operations would achieve significant savings. See Part I for the complete discussion of management comments and Part III for the complete text of management comments.

Audit Response. The DeCA comments to the second recommendation do not provide sufficient rationale for exempting the accounting staff from a cost comparison study. The above-store accounting function is primarily ministerial and internal in nature and not an inherently governmental function as defined by the Federal Activities Inventory Reform Act, which took effect on October 1, 1998. In previous inventories DeCA identified the accounting function as a commercial activity candidate for study. In view of these considerations and the Deputy Under Secretary of Defense (Industrial Affairs and Installations) concurrence, we request DeCA to reconsider its position on the recommendation and provide additional comments in response to the final report by April 6, 1999.

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Background

Defense Commissary Agency (DeCA). DeCA was created in 1991 through the consolidation of commissary systems operated by the Military Services. The agency operates 298 stores in the continental United States, Europe, and the Pacific that sell groceries, health and beauty products, and household supplies to members and retirees of the U.S. Armed Forces, their families, and other authorized patrons. During FY 1997, DeCA had sales totaling about \$5 billion and an operating budget, which is funded by Congressional appropriations, of about \$971 million. The stores sell products at acquisition cost plus a 5-percent surcharge, resulting in prices of up to 29.7 percent below typical supermarket prices. The 5-percent surcharge funds capital expenditures, including facility construction. The DeCA director reports to the Under Secretary of Defense (Personnel and Readiness) through the Assistant Secretary of Defense (Force Management Policy). The Defense Reform Initiative provides that in FY 1999, the determination of the amount of appropriated funding for DeCA will devolve to the Secretaries of the Military Departments, and the Defense Commissary Operating Board. This audit evaluated whether the DeCA commercial activities program resulted in appropriated fund savings while maintaining the commissary benefit.

Commissary Workforce. As of January 1, 1998, DeCA was authorized 17,646 full-time equivalent (FTE) employees. DeCA in-house workforce includes 15,335 FTEs at worldwide commissary locations and 1,267 management and field operating support personnel at four regional and area office locations and DeCA headquarters in Fort Lee, Virginia. The in-house workforce is almost totally composed of Federal Civil Service employees. The typical DeCA store is composed of customer service, grocery, meat, and produce departments.

Defense Science Board Outsourcing Recommendation. The Defense Science Board Task Force on Outsourcing and Privatization (Task Force) August 28, 1996 report concluded that DoD should contract out all infrastructure functions except those inherently governmental, directly involved in warfighting, or for which no adequate private sector capability exists. The Task Force noted that DeCA had undertaken streamlining initiatives to improve operations, but concluded that outsourcing the commissary function to a national grocery or retail chain would enhance DoD market power, and allow negotiation of more favorable prices from suppliers. The Task Force recommended that DoD initiate immediate action to outsource the commissary system while maintaining the benefit for military personnel. The report noted that appropriated funds would be required to maintain contractor prices below market levels, but required funding would be less than currently provided to DeCA. The report did not address potential cost avoidance amounts. Congress has prohibited DoD from implementing the Defense Science Board recommendation.

Office of Management and Budget Circular No. A-76. Office of Management and Budget (OMB) Circular No. A-76, "Performance of Commercial Activities," August 4, 1983, is the Government-wide policy for determining whether commercial activities should be contracted out or performed in-house. The OMB

Circular No. A-76 Revised Supplemental Handbook, "Performance of Commercial Activities," March 1996, which is the guide for conducting commercial activities studies, provides detailed guidance on how and when cost comparison studies are to be performed, and indicates what costs will be included in the comparison of in-house and contractor cost proposals. DoD Instruction 4100.33, "Commercial Activities Program Procedures," implements the OMB Circular A-76 and the Revised Supplemental Handbook

Objectives

The overall objectives were to determine the accuracy of inventories of commercial activities subject to study for outsourcing and privatization, evaluate the reasonableness of in-house cost estimates, and identify inherently governmental functions for outsourcing studies reported and initiated by the Defense agencies. In addition, we evaluated the adequacy of the DeCA management control program as it applied to the other stated objectives. See Appendix A for a discussion of the scope and methodology and details on the management control program. See Appendix B for a summary of prior coverage.

DeCA Commercial Activities Program

Although the DeCA commercial activities inventory reports for FYs 1996 and 1997 fairly presented the total in-house FTE personnel for operating locations, the coding of 2,431 in-house FTEs in FY 1996 and 788 FTEs in FY 1997 was faulty. The faulty coding was caused by DeCA interpretation of legislation and guidance. Additionally, operating cost reductions that DoD expected to achieve from the DeCA commercial activities program may not be realized because DeCA considers large cost comparison studies to be incompatible with its core function of delivery of a commissary benefit. Also, DeCA withdrew from a study involving 493 FTE accounting employees and has not rescheduled the study. As a result, future reporting of a significant number of FTEs as exempt from cost comparison study and the small-scale functions that DeCA plans to study and convert directly to contract during FYs 1999 through 2003 will limit the cost avoidance that DoD can expect from the DeCA commercial activities program.

Commercial Activities Inventory Reports

The DeCA commercial activities inventory reports for FYs 1996 and 1997 fairly presented the total in-house FTE personnel for the operating locations in the United States, Guam, and the Commonwealth of Puerto Rico. Table 1 summarizes the FYs 1996 and 1997 commercial activities inventory reports submitted by DeCA.

**Table 1. Defense Commissary Agency Commercial Activities Inventory
By Performance Category**

FTE Performance Category	FY 1996 FTE Inventory	FY 1997 FTE Inventory
Military and Civilian Employees		
Subject to A-76 Studies		
Or Direct Conversion	8,177	10,436
Scheduled for Cost Studies	0	105
Cost Studies in Progress	186	438 ¹
Exempt by Legislation	753	728
Exempt by Agency	1,678	--- ²
Exempt Inherently Governmental	--- ³	285
Exempt Because of Restructure	1,733	--- ²
Function Retained In-House	0	3
Sub total	12,527	11,995⁴
Contractor Personnel	<u>2,946⁵</u>	<u>2,952⁵</u>
Total	15,473	14,947

¹Only 187 FTEs were covered by the five cost studies in progress as of September 30, 1997

²Category was not required for the FY 1997 inventory

³Reporting was not required with the FY 1996 inventory

⁴Because of a calculation error, DeCA incorrectly reported a commercial activities inventory of 11,987 FTEs for FY 1997

⁵Includes personnel performing receiving, storage, handling, shelf stocking, and custodial services under DeCA services contracts, but does not include non-DeCA personnel operating delicatessen, bakery, or seafood specialty concessions in 146 commissaries pursuant to resale agreements

Commercial Activities Exempt From Study. DeCA coded 2,431 FTE employees as exempt from cost comparison study or contracting out in the FY 1996 inventory. DeCA identified 1,678 FTE employees as "Agency Exempt" in the FY1996 inventory but did not include this category in FY1997. Personnel in this category included produce and meat department managers, checkers, and cash clerks in the commissary stores. These positions were considered core store functions that should be performed by DeCA employees.

Positions Exempt by Legislation. DeCA considered seven occupational groups, totaling 753 FTEs and 728 FTEs, in the FYs 1996 and 1997 inventories as exempt from outsourcing based on paragraph (a) of 10 United States Code (U S C) 2482, "Commissary stores private operation" The statute states.

a contract with a private person for the operation of any commissary store may not require or permit the contractor to carry out functions for the procurement of products to be sold in the store or to engage in functions relating to the overall management of any such store DoD personnel shall carry out functions related to the procurement of products sold in stores or functions relating to the overall management of a commissary system or the management of any such store. Such functions shall be carried out by personnel of the Department of Defense under regulations approved by the Secretary of Defense.

DeCA identified six commissary store management positions and one contract administration position per store (for larger stores) as being subject to 10 U S C 2482(a) DeCA did not document rationale for the "Exempt by Legislation" determinations or have guidelines to implement 10 U S C 2482(a) The legislative history of 10 U.S C 2482(a) indicates that Congress intended to prohibit the contracting out of entire stores or their operations The DoD had previously conducted a full store contracting out "test" at Yuma, Arizona, which was terminated in 1986 because contractor operation of the commissary store was not found cost effective Officials at OMB and the Office of Under Secretary of Defense (Personnel and Readiness) believed that DeCA should interpret 10 U.S C 2482(a) to apply to DeCA management functions at above store (headquarters and regional) levels We believe that DeCA should develop guidance and supporting rationale to identify store management positions in the 1998 commercial activities inventory that are applicable to the "Exempt by Legislation" category

Inherently Governmental Positions. DeCA reported 285 FTE personnel as performing inherently governmental functions with its FY 1997 commercial activities inventory. Of the 285 FTE personnel reported as inherently governmental, about 60 nonsupervisory accountants, budget analysts, management analysts, and secretaries were working at DeCA headquarters and regional offices These nonsupervisory positions were identified as inherently governmental based on a broad interpretation of the guidance On April 20, 1998, in response to concerns that DoD Components were not uniformly identifying inherently governmental functions, the Under Secretaries of Defense (Acquisition and Technology) and (Personnel and Readiness) jointly issued guidance to the DoD Components for the FY 1998 inventories of inherently governmental functions and commercial activities. The additional guidance should result in more accurate and complete reporting of personnel performing inherently governmental functions at DeCA and other DoD Components.

Outsourcing Studies

DeCA performed seven cost comparison studies of small commissary functions during FYs 1997 and 1998 that resulted in significant appropriated fund cost avoidance. The DeCA management considers the study of store departments, which could achieve greater cost avoidance, to be incompatible with the core function of delivering a commissary benefit.

Cost Studies Performed. DeCA completed three cost comparison studies in FY 1997, two studies in FY 1998, and had two other studies pending completion as of September 30, 1998. The seven cost studies covered 219 FTE personnel at nine commissary stores in the United States. The 219 FTEs represented 28 percent of the 771 FTE personnel at the nine stores that were identified as performing commercial activities. The functions that were studied included receiving storage and holding, shelf stocking, and custodial services. Table 2 identifies the seven cost studies that DeCA performed.

Table 2. Defense Commissary Agency Cost Studies

<u>Commissary Location</u>	<u>Total FTEs</u>	<u>FTEs Studied</u>	<u>MEO FTE</u>	<u>Cost Comparison Decision</u>	<u>Functions Studied²</u>	<u>Study Decision Date</u>
Camp Pendleton	121	26	19	Contract	1/2	9/23/97
Ft Bragg ¹	223	71	³	⁴	1/2/3	⁴
Ft. Drum	81	24	³	⁴	1/2/3	⁴
Ft. Lewis	173	43	31	Contract	1/2/3	10/10/96
Ft Leonard Wood	88	30	27	Contract	1/2/3	3/31/98
San Onofre	22	7	4	MEO	1/2	8/14/97
Kaneohe Bay	<u>63</u>	<u>18</u>	10	Contract	1/2/3	2/13/98
Total	771	219				

¹ Combined study of commissaries at Fort Bragg, Mallonee Village and Pope Air Force Base

² Functions studied included: 1) shelf stocking, 2) receiving, holding and storage, and 3) custodial services

³ Procurement sensitive information

⁴ Final cost comparison decision pending as of 9/30/98

Savings and Costs The five completed cost studies have achieved significant net cost avoidance of appropriated funds. We estimate that DeCA incurred costs of \$700,000 to \$800,000 per year for FYs 1997 and 1998 to conduct its commercial activities program. In comparison, the competitions between the in-house DeCA workforce and contractors achieved yearly cost avoidance of about \$1 million. An additional annual cost avoidance of about \$1.8 million was achieved for the

51 FTE personnel that DeCA identified as over and above the most efficient organization (MEO) needed to perform the functions Table 3 summarizes cost avoidance through the competitions

**Table 3. Defense Commissary Agency Commercial Activities
Cost Avoidance through Competition
(in millions)**

<u>Commissary Location</u>	<u>5-Year Government Bid</u>	<u>5-Year Contractor Bid¹</u>	<u>Difference</u>	<u>5-year Comparison Savings²</u>
Camp Pendleton	\$ 4.3	\$ 3.8	\$.5	\$.5
Ft. Lewis	8.4	6.5	1.9	1.9
Ft. Leonard Wood	5.0	3.0	2.0	2.0
San Onofre	8	.9	(1)	-
Kaneohe Bay	<u>2.6</u>	<u>1.9</u>	<u>.7</u>	<u>.7</u>
Total	\$21.1	\$16.1	\$5.0	\$5.1

¹Includes Government contract administration costs and applicable start up costs

²Actual cost avoidance is greater because the 5-year Government bid includes annual savings of \$1.8 million over present operations if the Government's most efficient organization structure was implemented

Contractors won four of the five competitions with bids that averaged 24 percent below the Government bids

Independent Reviews. OMB Circular No. A-76 Revised Supplemental Handbook and DoD Instruction 4100.33 require that all cost comparison studies be reviewed and certified in writing by an impartial official organizationally independent of the commercial activity being studied, and the organization preparing the cost comparison. Internal review auditors at DeCA performed the independent reviews for each of the seven cost comparison studies performed. The independent reviews certified that the management plan and in-house cost estimates reasonably supported the Government's ability to perform the performance work statement. The independent reviews were supported by detailed referenced working papers. The internal review auditors of DeCA were organizationally independent of the personnel performing the studies.

Planned Outsourcing

DeCA has identified functions performed by about 700 FTE employees for cost studies or direct conversion to contract during FYs 1998 through 2003. During 1998, DeCA withdrew plans to perform a cost study involving 493 FTE in-house accounting personnel and has not rescheduled the study.

Planned Cost Studies. DeCA planned to begin four cost studies of functions performed by 152 FTEs in FY 1999, and to complete the studies during FYs 2000 or 2001. The four studies will evaluate shelf stocking, custodial, receiving, storage and handling functions and cover 28 to 43 FTEs per study.

Planned Direct Conversions. In August 1997, the DeCA Chief Executive Officer announced an initiative to convert grocery storage, holding, shelf stocking, and custodial functions performed by 666 FTE personnel at 136 commissary stores directly to contract. Each store has 10 or fewer FTEs. The timetable for completing the direct conversions was between October 1, 1998, and October 1, 1999. As of March 1998, DeCA had converted 51 FTEs at eight commissary stores to contract. DeCA estimates that the direct conversions will recoup between \$2.5 to \$3.5 million per year, based on funds put to better use of 14 to 20 percent realized by the former Air Force Commissary Service in the direct conversion of the warehouse function at 60 commissary stores. DeCA had no documentation to support the cost avoidance estimate, which is substantially less than the cost avoidance DeCA realized by performing the five cost studies and competing the functions.

Accounting Operations Study. On June 27, 1997, the DeCA Chief Executive Officer informed the Defense Finance and Accounting Service (DFAS) that DeCA would perform a cost study of 493 FTE in-house accounting personnel concurrent with a DFAS cost study of its DeCA vendor pay function. On September 12, 1997, DeCA notified DFAS that it was withdrawing because of regional reorganization. DeCA felt that implementing a new Defense Commissary Information System would negatively impact development of an in-house most efficient organization. Even though DeCA completed the regional reorganization in early 1998, and canceled implementing the information system in May 1998, DeCA has no plans to conduct a cost study of its accounting operations. We believe that a study of this area could indicate cost avoidance opportunities and that a study should be scheduled during FYs 1999 or 2000.

Defense Commissary Agency Core Function

DeCA management considers a study of major commissary functions to be incompatible with the core function of delivery of a commissary benefit and believes that extensive outsourcing would result in a loss of control. DeCA has planned and performed cost studies of receiving, shelf stocking, and custodial functions because the Military Services had studied these functions for outsourcing before DeCA was established. DeCA has exempted commissary positions such as

store checkers and cash clerks from the cost study because contracting out these functions could lead to contracting out an entire commissary store. An internal November 18, 1996, DeCA memorandum states that DeCA will only schedule cost studies on receiving, shelf stocking, and custodial functions unless DoD imposes another outsourcing study schedule and criteria.

Management Comments on the Finding and Audit Response

DeCA Comments on Positions Exempt by Legislation. DeCA considers six rather than nine occupational groups to be exempt from outsourcing in the FY 1996 and 1997 commercial activities inventories based on legislation. The six occupational groups are

Commissary Officer
Assistant Commissary Officer
Store Manager
Assistant Store Manager
Grocery Department Manager
Distribution Facilities Manager

DeCA also considers one additional group, Quality Assurance evaluator, both exempt by legislation and inherently governmental in nature.

Audit Response. We revised the finding to note that DeCA considered seven occupational groups (the six store management groups and the Quality Assurance Evaluator) to be exempt by legislation.

DeCA Comments on Agency Exempt Positions. DeCA noted that its FY 1998 commercial activities inventory lists commissary store checkers and cash clerks as subject to a future outsourcing study. The FY 1996 inventory had categorized these employees as "Agency Exempt."

DeCA Comments on Receiving, Shelf Stocking, and Custodial Functions. DeCA disagreed with the draft report statement that DeCA had planned and performed cost comparison studies of receiving, shelf, stocking, and custodial functions because the Air Force Commissary Service had studied these functions for outsourcing and the other Military Services had not. DeCA stated that all the Military Services had studied the receiving, shelf, stocking, and custodial functions for outsourcing prior to the establishment of DeCA.

Audit Response. We modified the statement regarding performance of cost comparison studies of commissary functions by the Military Services.

DeCA Comments on Accounting Functions. DeCA did not agree with the draft report statement that a cost avoidance will not occur because DeCA withdrew from a cost comparison study of its accounting function. DeCA stated that its 1997 decision to withdraw 493 DeCA accounting personnel from a DFAS-sponsored outsourcing study was justified because DeCA believed that accounting

functions performed by DeCA personnel would significantly change when a new DeCA bill-paying process was implemented. DeCA stated that the 493 accounting personnel were employed within three functional areas: an Analysis and Reconciliation Business Unit located at DeCA headquarters, a Budget Liaison Office, and an Accounts Control Section. A Budget Liaison Office and an Accounts Control Section is located at each of the three DeCA regional offices. DeCA also stated that it is required by DoD to obtain eight categories of accounting services from DFAS at an average cost of \$18.6 million during FYs 1997 and 1998.

Audit Response. After withdrawing from the DFAS-sponsored outsourcing study of accounting support provided to DeCA, DeCA abandoned implementation of the Defense Commissary Information System. The DeCA decision not to study its accounting functions, which are a commercial activity, removed the opportunity for a cost avoidance through competitive performance of the work.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Commissary Agency:

- 1. Develop guidance for personnel identified as "Exempt by Legislation" in the 1998 commercial activities inventory.**

DeCA Comments. DeCA concurred and stated that the Agency would develop policy guidance by June 15, 1999, to identify store management positions applicable to the "Exempt by Legislation" category.

Under Secretary of Defense (Acquisition and Technology) Comments. The Deputy Under Secretary of Defense (Industrial Affairs and Installations) agreed with the recommendation. He stated that the clarification was needed because DeCA had increased the number of personnel exempt under the provision of law, Executive order, treaty, or International Agreement in its FY 1998 commercial activity inventory from the 753 and 728 FTEs in the FY 1996 and 1997 inventories, to 3,567 positions in the FY 1998 inventory.

- 2. Initiate an outsourcing study of above-store level accounting operations during FY 1999 or 2000.**

DeCA Comments. DeCA nonconcurred and stated it considered some regional headquarters accounting operations personnel exempt from outsourcing study based on agency determination that the personnel provided essential core civilian manpower. In addition, DeCA stated that Accounts Control Section personnel at regional locations were also exempt from outsourcing study based on an agency determination that the personnel provided a critical (although non-core) Government presence. DeCA noted that its determination was based on provisions of an April 20, 1998, Under Secretary of Defense (Personnel and

Readiness) and Under Secretary of Defense (Acquisition and Technology) memorandum on inherently governmental and commercial activities inventory procedures

Under Secretary of Defense (Acquisition and Technology) Comments. The Deputy Under Secretary of Defense (Industrial Affairs and Installations) concurred and stated that the DeCA FY 1998 inventory exempted 335 positions from competition due to the DeCA Director's management decision that the use of a commercial source would cause unacceptable risks. The Deputy Under Secretary noted that most of these positions involved above-store accounting operations. The Deputy Under Secretary agreed with the draft report conclusion that a cost comparison study of DeCA accounting operations could achieve significant savings.

Audit Response. DeCA comments do not provide sufficient rationale for exempting the accounting staff from a cost comparison. The above-store accounting function is primarily ministerial and internal in nature and not an inherently governmental function as defined by the Federal Activities Inventory Reform Act, which took effect on October 1, 1998. In previous inventories DeCA identified the accounting function as a commercial activity candidate for study. In view of these considerations and the Deputy Under Secretary of Defense (Industrial Affairs and Installations) concurrence, we request DeCA to reconsider its position on Recommendation 2 and provide additional comments in response to the final report.

Appendix A. Audit Process

Scope and Methodology

We analyzed and validated the FYs 1996 and 1997 commercial activities inventory database on file with DoD for DeCA commercial activities submissions. In addition, we performed on-site reviews and analyses of commercial activities inventory and the cost comparison study processes at DeCA to determine compliance with OMB Circular A-76 and DoD requirements. We reviewed DeCA cost comparison studies completed in FYs 1997 and 1998 including supporting rationale and independent reviewer certifications. We analyzed the DeCA management controls over the commercial activities inventory and the cost comparison studies.

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, DoD has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal:

Objective: Fundamentally reengineer DoD and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. (DoD-6)

General Accounting Office High Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Infrastructure high-risk area.

Use of Technical Assistance and Computer Processed Data. We did not use technical assistance or computer-processed data in the performance of the audit.

Audit Type, Dates, and Standards. We performed this economy and efficiency audit from November 1997 through September 1998 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available upon request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," dated August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of DeCA management controls over the commercial activities inventory. We also reviewed DeCA management controls over the OMB Circular A-76 Commercial Activities program and independent reviews.

Adequacy of Management Controls. The DeCA management controls were adequate to ensure that they met OMB Circular A-76 cost comparison study requirements and the DeCA commercial activities inventory was generally current and complete.

Appendix B. Summary of Prior Coverage

General Accounting Office

Report No NSIAD-95-200-BR, "1996 DoD Budget Potential Reductions to the Operation and Maintenance Program," September 26, 1995

Congressional Budget Office

Congressional Budget Office Study, "The Costs and Benefits of Retail Activities at Military Bases," October 1997

Defense Science Board

"Report on the Defense Science Board Task Force on Outsourcing and Privatization," August 28, 1996

Appendix C. Report Distribution

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Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Technical Information Center, National Security and International Affairs Division,

General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Government Reform in the 106th Congress

House Subcommittee on Government Management, Information, and Technology,

Committee on Government Reform in the 106th Congress

House Subcommittee on National Security, International Affairs, and Criminal Justice,

Committee on Government Reform in the 106th Congress

House Committee on Armed Services in the 106th Congress

Under Secretary of Defense (Acquisition and Technology) Comments



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000



January 14, 1999

MEMORANDUM FOR DIRECTOR OF CONTRACT MANAGEMENT
OFFICE OF THE DOD INSPECTOR GENERAL

THRU: DIRECTOR, CONGRESSIONAL REPORTS AND INTERNAL REPORTS *1/14/99*

SUBJECT: Draft Audit Report on Outsourcing of Defense Commissary Agency
Operations (Project No 8CH-0008 00)

I have reviewed the Draft Audit Report on Outsourcing of Defense Commissary Agency Operations and concur with the recommendations in the report. Although Defense Commissary Agency's (DeCA) FY 98 Commercial Activities (CA) Inventory indicates that 63% or 11,136 positions are subject to competition or direct conversion, the report recommends sound methods of producing additional candidates.

It is appropriate that the Director, DeCA develop guidance and supporting rationale to clarify which personnel are exempted from competitive sourcing on the basis of 10 United States Code (U.S.C.) 2482. The draft report indicates that 753 and 728 Full Time Equivalents, in the FY 1996 and 1997 CA Inventories, respectively are exempt from competition by 10 U.S.C. 2482. However, DeCA's FY 98 CA Inventory exempted 3,567 positions from competition because of a specific provision of law, Executive Order, treaty, or International Agreement. Further clarification would produce additional candidates for competition.

DeCA's FY 98 CA Inventory also exempted 335 positions from competition due to the Director's management decision that use of a commercial source would cause unacceptable risks. Most of these positions involve above-store accounting operations. I agree with the draft report that a study of this area could achieve significant savings.

I appreciate the opportunity to comment on this report

Steven C. Grundman
Acting Deputy Under Secretary
(Industrial Affairs and Installations)



Defense Commissary Agency Comments



REPLY TO
ATTENTION OF

DEFENSE COMMISSARY AGENCY
HEADQUARTERS
1300 E AVENUE
FORT LEE, VIRGINIA 23801-1800

IR


JAN 11 1999

MEMORANDUM FOR INSPECTOR GENERAL, CONTRACT MANAGEMENT
DIRECTORATE, 400 ARMY NAVY DRIVE, ARLINGTON, VA
22202-2884

SUBJECT: Audit Report on Outsourcing of Defense Commissary
Agency Operations (Project No. 8CH-0008.00)

Reference: DoDIG Memorandum, November 5, 1998, SAB

Attached is the DeCA reply to the recommendations provided
in subject report. If you have any questions, please contact Mr.
Ben Mikell at (804) 734-8103.


CROSBY H. JOHNSON
Executive Director for Support

Attachment:
As Stated

DEFENSE COMMISSARY AGENCY REPLY

SUBJECT: Audit Report on Outsourcing of Defense Commissary
Agency Operations (Project No. 8CH-0008.00)

ADDITIONAL COMMENTS RELATED TO RECOMMENDATION 1

The audit report identified nine occupational groups as exempt by legislation. DeCA considers six rather than nine occupational groups as exempt by legislation. The six occupational groups are:

1. Commissary Officer
2. Assistant Commissary Officer
3. Store Manager
4. Assistant Store Manager
5. Grocery Department Manager
6. Distribution Facilities Manager

Additionally, one group, Quality Assurance Evaluator, is exempt because it is an inherently governmental in nature group.

The DoDIG used nine occupational groups based on a DeCA internal memorandum, dated October 22, 1996 that discussed one occupational group using three different descriptions to describe one position. This occupational group is related to Quality Assurance Evaluator. DeCA, in its internal memorandum, was describing one occupational group where different servicing civilian personnel offices used different position titles for the same position. This memorandum when describing the Quality Assurance Evaluator also used the terms "Contract Performance Evaluator" and "Commissary Contract Monitor". We therefore disagree with the number of occupational groups being nine. These occupational groups should be six groups exempt by legislation and one group exempt as inherently governmental in nature.

The audit report states that "DeCA has planned and performed cost studies of receiving, shelf stocking, and custodial functions because the Air Force Commissary Service had studied these functions for outsourcing before DeCA was established while the other Services had not." This is an incorrect statement.

These functions had been studied and were under study by all military services when DeCA was established. The commissary systems continued to announce and perform these studies when the Congressional moratorium was not in place. DeCA, in its 1998 Inventory Report, listed store checkers and cash clerks as

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subject to A-76 study. The November 18, 1996 memorandum referred to is no longer valid in view of the DeCA 1998 inventory.

RECOMMENDATION 1. Develop guidance for personnel identified as "Exempt by Legislation" in the 1998 commercial activities inventory.

DeCA REPLY. CONCUR. DeCA will develop policy guidance to identify store management positions that are applicable to the "Exempted by Legislation" category. Store management positions that are applicable to the "Exempted by Legislation" category are:

- Commissary Officer
- Assistant Commissary Officer
- Store Manager
- Assistant Store Manager
- Grocery Department Manager
- Quality Assurance Evaluator
- Distribution Facilities Manager

Expected completion date June 15, 1999.

ADDITIONAL COMMENTS RELATED TO RECOMMENDATION 2

In 1997, DFAS announced an A-76 study of accounting support that included 493 DeCA accounting positions. The DoDIG audit report stated that "Cost avoidance will not occur because DeCA withdrew from a study involving 493 full time equivalent accounting employees and has not rescheduled the study." This statement is incorrect. DeCA was not studying the 493 positions; DFAS was studying these positions.

DeCA is required by DoD to obtain accounting services from DFAS. DeCA pays for those services by a direct reimbursement to DFAS at rates set by DFAS. These DFAS rates are not negotiated. DFAS bills DeCA the billing rate for the workload within eight categories of accounting. These eight categories are:

- Civilian accounts maintained.
- Contract invoices paid.
- Travel vouchers paid.
- Commercial invoices paid.
- Monthly trial balances.
- Accounting and Finance support
- Transportation bills paid.
- Out of service debt cases closed.

Each of these categories has separate rates established. The cost to DeCA for FYs 1997 through 1998 has averaged \$18.6 million per year. DeCA does not control the manpower associated with this support.

The 493 positions referred to in the audit report Executive Summary and finding are DeCA employees performing separate and distinct functions in the following areas:

1. The Analysis and Reconciliation Business Unit, located at DeCA Headquarters:

Reconciles commissary inventories to the financial records.

Reviews and processes error corrections requested from the Region Accounts Control Sections (ACS).

Reviews the Cash Reconciliation Report from each commissary's Financial Records to determine missing collection information.

2. The Budget Liaison Office, located at Headquarters and each Region Headquarters:

Records commitments, obligations, and expenses of the Defense Working Capital Fund and the Surcharge Collections Fund.

Reviews financial reports generated by DBMS to include accounts payable, obligations without expenses, Negative Unliquidated Obligations, and open commitments. The Budget Liaison Offices research and provide follow-up with appropriate organizations to obtain documentation to record expenses and to validate unliquidated obligations. Processes documents such as receiving reports.

3. The Accounts Control Sections. These are store level accounting positions but located at the Region Headquarters.

Inputs sales, receipts, inventory transfers, Vendor Credit Memorandums, and accounting adjustments into DeCA Interim Business System (DIBS).

Reconciles the receipts and deposits to accounting records to ensure that all documents from the commissary are properly recorded in the financial records.

Defense Commissary Agency Comments

Prepares the Record of Operations to ensure proper accountability and reconciliation of gains and losses in inventory.

Provides follow-up with commissaries for missing documents needed to support financial transactions.

Reconcile processed and unprocessed credit card transactions where the "store and forward mode" of processing transactions is required because of communications outages.

DeCA initially made the decision to participate in the DFAS study of accounting functions performed in support of DeCA operations. However, it became apparent that the functions being performed by DeCA employees would significantly change when the new DeCA bill paying processes were implemented. In addition, the consolidation of our six CONUS regions into three, relocating personnel into new facilities, and the stand up of our accounts control sections had a much greater impact than originally expected. As such, performance requirements were in a state of change, i.e. Performance Work Statement could not be prepared which adequately described the tasks to be performed. Further, no validated workload data was available to support the preparation of the required Most Efficient Organization documents. At the time of withdrawal of the DeCA portion of the announced study, it would have been impossible for DFAS to do a valid A-76 study of the DeCA accounting functions. This could have invalidated the total announced study.

Therefore DeCA nonconcurs with the general categorization in the executive summary and report that: "Cost avoidance will not occur because DeCA withdrew from a study..."

RECOMMENDATION 2. Initiate an outsourcing study of above-store level accounting operations during FY 1999.

DeCA REPLY. NONCONCUR. The accounting operations positions at the Region Headquarters level are exempt because these positions are the minimum number of positions needed to maintain adequate levels of oversight, control and accountability over government operations. The Memorandum from the Office of Secretary of Defense, dated April 20, 1998, Subject: Inherently Governmental and Commercial Activities Inventory Procedures, paragraph 2.2.2 provides that core civilian essential manpower requirements are required to ensure that civilian decision making officials maintain sufficient levels of oversight, control and accountability over government operations and federally funded

projects and tasks. The incumbents in these positions provide corporate knowledge and technical expertise necessary to ensure that government and public interest are advanced:

In addition, accounting positions at the store level Accounts Control Section (ACS) have been waived. Paragraph 2.3.3.1 of the Memorandum from the Office of Secretary of Defense provides that non-core manpower requirements have been exempted from cost comparison or direct conversion to private sector performance by a DoD official that exercises management authority over a functional area. Paragraph 2.3.3.1.1 provides that this authority is vested in Directors of Defense Agencies. DeCA has determined that these positions are exempt from CA study because they provide the critical government presence in the cycle of receiving \$5 billion of merchandise for sale and the receipt of federal funds for merchandise sold. The ACS function is the focal point for the review, validation, approval, and recording of financial obligations generated by suppliers delivery of inventory and services to each commissary. These personnel extend prices on delivery tickets and compute the value of each government receipt which represent payments to commercial contractors. Additionally, personnel at each ACS are appointed as certifying officers by the disbursing officer at the Defense Finance and Accounting Service, Columbus Center. As certifying officers, they are responsible and accountable for the review, validation, recording, and certifying of financial information that results in payments to commercial contractors.

Audit Team Members

The Contract Management Directorate, Office of the Assistant Inspector General
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